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RUCPDOC/DEPT OF COMMERCE
RHEBAAA/DEPT OF ENERGY
RUEATRS/DEPT OF TREASURY
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UNCLAS SECTION 01 OF 03 CARACAS 000667

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD
ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD

E.O. 12958: N/A
TAGS: EFIN EPET VEN
SUBJECT: PDVSA'S MEGA USD 5 BILLION BOND ISSUE

REF: A. 05 CARACAS 2596

¶B. CARACAS 183
¶C. CARACAS 305
¶D. CARACAS 448
¶E. CARACAS 493

¶1. (SBU) SUMMARY: On April 12 PDVSA is scheduled to issue USD 5 billion in debt. This bond sale represents the largest issuance of debt in Venezuelan history, and one of the largest for emerging markets. The bonds are dollar-denominated Eurobonds and will almost certainly be resold by most local buyers in secondary markets outside Venezuela to obtain dollars. The announcement has driven the parallel market rate down from nearly Bs 4000/USD to around Bs 3500/USD. The low yield and inherent risks associated with these bonds means that buyers do not have the guaranteed return they did with the previous "bonos del sur" sale. The issuance size, in today's high oil-price environment, points clearly to Chavez' reliance on PDVSA as the BRV,s cash cow, and to how little freedom PDVSA has had to invest in its own operations. END SUMMARY.

¶2. (SBU) After months of speculation, Minister of Popular Power for Energy and Petroleum (MPPEP) Ramirez announced on March 22 that PDVSA would issue USD 5 billion in bonds in the coming weeks. The bonds, a combination of three securities with maturity dates of 2017, 2027, and 2037 and yields of 5.25 percent, 5.37 percent and 5.50 percent, respectively, are scheduled to be allocated on April 2 and issued on April ¶12. The minimum purchase is USD 1000, which provides USD 400 worth of bonds maturing in 2017, USD 400 maturing in 2027, and USD 200 maturing in 2037. These Eurobonds are dollar denominated and pay interest and principal in dollars. They will be sold locally at 105.5 percent of face value at the official exchange rate (Bs 2150/USD) and are tax-free in Venezuela. The lead bank is ABN AMRO, and the bonds will initially be quoted on the Luxembourg exchange. The bonds are not registered with the SEC and thus cannot be traded within the United States until 40 days after issuance.

¶3. (SBU) The bond issuance is ostensibly to "stimulate internal savings through a secure investment for Venezuelans and their direct participation in the petroleum industry," though most purchasers are surely more interested in obtaining dollars to get their money to a safe harbor outside

of Venezuela, rather than participating in the local petroleum industry. PDVSA has been accruing substantial debt lately; having also recently obtained USD 1 billion in financing from BNP Paribas (reftel C) and USD 3.5 billion from a consortium of Japanese groups (reftel D). Ramirez announced that the offering would be targeted at "small investors, workers' saving accounts, pension funds, medium investors, companies, and large investors." (COMMENT: While running the gambit of anyone potentially having funds to purchase a bond in Venezuela, it also calls into question whether pension funds or savings accounts should hold junk bonds. END COMMENT.)

¶4. (SBU) Standard and Poors and Fitch Ratings both rate the issuance at BB- (barely junk status). Given the low yield offered by these bonds, they will trade at a discount to face value. The economic daily "Reporte" estimates that discounts will range from 81 percent of face value (2017) to 73 percent (2027) to 70 percent (2037), which gives the aggregate a trading discount of 76 percent of face value (read: a USD 1000 bond will be resold for USD 760). Combining the sale price, commissions, and eventual discount when sold abroad yields an exchange rate value of Bs 3044/USD. JP Morgan estimates a slightly lower discount of 78.6 percent of face value. In general, analyst estimates of the implicit rate based on the eventual discount range between 2900 and 3200 bolivars/dollar. The current parallel market rate is hovering around Bs 3500/USD, demonstrating that an arbitrage potential exists, though one no where near the size of the "bonos del sur" issuance, which cost around Bs 2800/USD during a time when the parallel rate was nearly Bs 4000/USD (reftel E).

¶5. (SBU) The parallel market for dollars has fallen since the announcement from Bs 4000/USD to Bs 3500/USD. Unlike the

recent "bonos del sur" issuance, it seems likely that the PDSVA bonds will, at least temporarily, meet some of the foreign exchange needs in the Venezuelan economy. The Commission for the Administration of Foreign Exchange (CADIVI) approvals shot up from an average of around USD 90 million daily in 2006 to USD 142 million daily in January to USD 166 million a day in February (though in March are running closer to the average of USD 90 million daily) and this may have also relieved pressure on the parallel market. Additionally, it is tax season in Venezuela and many wealthy Venezuelans are converting dollars back into bolivars in order to pay their income tax obligations.

¶6. (SBU) 500,000 Venezuelans and Venezuelan companies have applied for an allocation and similar to the "bonos del sur," many investors are submitting multiple requests using identity documents from friends and co-workers. One brokerage contact estimated that the ten brokers in her office had together submitted 1,600 requests just for themselves. The President of a local multinational bank estimated that individuals could receive as much as USD 10,000 each and corporations as much as USD 150,000. These amounts would not be sufficient for corporations looking to repatriate profits or obtain dollars for commercial-scale imports. The Ministry of Popular Power for Finance (MPPF) has already announced that it is planning a third round of the "bonos del sur" and PDVSA has hinted that it may issue more debt this year. By providing outlets to dollars, these issuances have a guaranteed market within Venezuela, but at some point the demand for Venezuelan debt in secondary markets may be met, at which point the value of using these bonds to get dollars will be offset by the heavy discount required to unload them outside of Venezuela.

¶7. (SBU) Another BRV claim is that this issuance will work to soak up excess liquidity and combat Venezuela's high inflation, which has been over 20 percent during the past 12 months. While the bonds will temporarily remove USD 5 billion worth of bolivars from the Venezuelan economy, they

will likely return to the economy in the form of PDVSA spending. PDVSA has said that it will convert the bolivar proceeds to dollars through the Central Bank (BCV) and then use those dollars to fund investment purchases abroad. This would prevent the money from reentering the Venezuelan economy, but we judge it to be unlikely. Almost all of PDVSA's revenues are already in dollars, so it should have no need for more dollars. In addition, by converting PDVSA's bolivar proceeds to dollars, the BCV will be depleting Venezuela's foreign exchange reserves by USD 5 billion (or over 15 percent) overnight at the same time that the BCV is supposed to be transferring an additional USD 4-5 billion to the National Development Fund (FONDEN), severely crimping its ability to manage the money supply and interest rates.

¶8. (SBU) PDVSA claims that this money is needed for investment as part of its "Plan Siembra Petrolera" (reftel A), which intends to invest USD 70 billion to double Venezuela's oil production by 2012. A more likely scenario is that this money will be used to pay current PDVSA obligations, rather than fund future investment. There are increasing signs that PDVSA is having cash flow problems (reftel B) in view of its huge social spending obligations. Many sources confirm that PDVSA has had trouble paying its bills lately. In addition, its liabilities are growing. PDVSA will pay about USD 840 million to nationalize the Caracas and Margarita Island electrical utilities and will need to compensate the companies in the Faja who will be converted to 60-40 joint ventures on May 1. Contacts have also told us that PDVSA will use the proceeds to pay its joint venture partners in the former Operating Service Agreement fields.

¶9. (SBU) COMMENT: The PDVSA bond issuance had been expected since the end of 2006, but the timing nonetheless seemed a little rushed (taking place in the middle of Holy Week when most Venezuelans will be on vacation). PDVSA has not published audited financial results for 2006; each time it does produce financial information, the information tends to contradict earlier published data. By not registering with the SEC, PDVSA avoids having to provide a lot of

documentation it may not be able to produce. The cash flow problems that are plaguing PDSVA in part stem from its massive obligations to the state (which totaled as much as USD 39 billion in 2006) and a lack of financial controls. Despite claims that the debt issuance is destined for investment (which is woefully lacking), our expectation is that most of the money will be used to pay off current liabilities. Given Chavez's insatiable appetite for spending and PDVSA's role as the cash cow for that appetite, it seems likely that further loans and debt issuances will occur if only to keep feeding the beast. With the USD 5 billion in new debt, PDVSA's debt load will increase to about USD 12 billion, which remains quite manageable for a company that had over USD 100 billion in revenues in 2006. END COMMENT.

BROWNFIELD